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## Viewing cable 10KUALALUMPUR103, MALAYSIA'S NEW ECONOMIC MODEL: ECONOMIC REFORM EFFORTS MAY MEET OPPOSITION

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### Understanding cables

Every cable message consists of three parts:

- The top box shows each cable's unique reference number, when and by whom it originally was sent, and what its initial classification was.
- The middle box contains the header information that is associated with the cable. It includes information about the receiver(s) as well as a general subject.
- The bottom box presents the body of the cable. The opening can contain a more specific subject, references to other cables ([browse by origin](#) to find them) or additional comment. This is followed by the main contents of the cable: a summary, a collection of specific topics and a comment section.

To understand the justification used for the classification of each cable, please use this [WikiSource](#) article as reference.

### Discussing cables

If you find meaningful or important information in a cable, please link directly to its unique reference number. Linking to a specific paragraph in the body of a cable is also possible by copying the appropriate link (to be found at the paragraph symbol). Please mark messages for social networking services like Twitter with the hash tags **#cablegate** and a hash containing the reference ID e.g. #**10KUALALUMPUR103**.

Reference ID	Created	Released	Classification	Origin
<a href="#">10KUALALUMPUR103</a>	<a href="#">2010-02-19 08:12</a>	<a href="#">2011-08-30 01:44</a>	<a href="#">CONFIDENTIAL</a>	Embassy Kuala Lumpur

Appears in these articles:

<http://www.malaysia-today.net/mtcolumns/40738-wikileaks-malaysias-new-economic-model>

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C O N F I D E N T I A L SECTION 01 OF 05 KUALA LUMPUR 000103

SIPDIS

STATE FOR EAP/MTS FOR DBISCHOF  
STATE FOR EEB/IFD/OMA FOR BSAUNDERS AND AWHITTINGTON  
STATE PASS USTR - WEISEL AND BELL  
STATE PASS FEDERAL RESERVE AND EXIMBANK  
STATE PASS FEDERAL RESERVE SAN FRANCISCO TCURRAN  
SINGAPORE PASS SBLEIWEIS  
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SUBJECT: MALAYSIA'S NEW ECONOMIC MODEL: ECONOMIC REFORM EFFORTS MAY MEET OPPOSITION

REF: A. 09 KUALA LUMPUR 303

[B.](#) 09 KUALA LUMPUR 318

[C.](#) 09 KUALA LUMPUR 887

**¶1.** (C) Summary: Prime Minister Najib Razak (Najib) introduced a first wave of limited economic reforms (refs A and B) shortly after taking office in April 2009 and has promised more substantial economic reforms designed to improve Malaysia's competitiveness (ref C). To accomplish this, Najib formed the National Economic Advisory Committee (NEAC) to develop a New Economic Model (NEM), an economic policy roadmap which he hopes will lead Malaysia from middle income to high income country status. Little has been revealed about the contents of the NEM, but government officials say it is intended to address Malaysia's "stagnating" economy, by improving education, reducing corruption, strengthening weak public institutions, reconfiguring emigration, cutting back on government over-involvement in the private sector, and increasing low domestic investment rates. Leading Malaysian economists believe that Najib is sincere in his desire to address these problems. However, they question his ability to make major changes in the government's long-standing discriminatory Bumiputera preference policies which have discouraged domestic investment and new business formation and are driving the "brain drain" of young professional Malaysians frustrated with limited opportunities under this system. Economists here expect Najib's effort to establish a policy framework that will foster a more gradual move away from ethnic preferences to a merit-based economy, but believe that may be insufficient. If PM Najib is unable to deliver on NEM reforms, they expect the opposition will seize the reform agenda as an issue for possible 2012 elections. Executing a robust NEM, however, will be even more difficult as the PM will undoubtedly face steady opposition from within his own political party (UMNO), particularly from members who fear their parliamentary seats may be lost if the current patronage system is dismantled. End Summary.

#### The New Economic Model: Reigniting High Growth

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**¶2.** (C) Since Prime Minister Najib Tun Razak (Najib) took office in April 2009, he has called for Malaysia to move from a low value-added, manufacturing-for-export oriented middle income economy to a knowledge-based service oriented high income economy. He has used the rubric of former Prime Minister Mahathir's Vision 2020 goal of reaching "high-income country" status by the year 2020 as his call to action to justify developing a "New Economic Model" (NEM) to promote economic transformation. PM Najib quickly announced an investment liberalization agenda and by April 2009 implemented a first tranche of reforms aimed at reducing bumiputra (ethnic Malays and other non-Chinese or Indian ethnicities) ownership requirements in 27 different non-influential service sectors (e.g. veterinary services and ship salvage and reflootation services) and allow foreign controlling ownership interests in some types of financial institutions (Ref A). PM Najib announced a second tranche of reforms late in April including reducing bumiputra ownership requirements on all listed companies from 30% to 12.5% and repealing Foreign Investment Commission guidelines on new mergers and acquisitions by foreign firms (Ref B). In July, PM Najib formed the National Economic Advisory Committee (NEAC) and charged the new body - made up of high profile Malaysian and non-Malaysian economic figures - with developing the NEM. In his October 23 budget speech (Ref C), PM Najib promised additional economic reforms.

Financial Crisis and Capital Flight Push GOM to Reform

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¶3. (C) Najib has been forced to consider a broader reform program because the Global financial crisis (GFC) has put tremendous pressure on the underpinnings of Malaysia's economic growth. FDI has slowed to a trickle, \$15 billion of portfolio investment departed in 2009 and has just begun to return, and there remain large domestic reverse investment outflows as Malaysian conglomerates focus on overseas rather than domestic investment. According to a January 8 UBS Securities report, Malaysia experienced net capital out flows in excess of \$27 billion from mid-2008 to mid-2009. More telling, the UBS report states Malaysia has not experienced net capital inflows in any one calendar year since 1997. UBS cites domestic investors investing outside Malaysia as the primary source of the outflows. PriceWaterhouse Coopers Consulting Malaysia (PWC) General Manager Pearlene Cheong described Western multi-national corporate interest in investing in Malaysia as "dormant" and that ethnic Chinese Malaysians had been taking their money out of Malaysia ever since the Asian financial crisis. She said that PWC's investor advisory business has seen primarily North Asian investors working in the extractive industries focused in East Malaysia and added, "This is not the knowledge-based type of employment that the government is looking for to stimulate wage growth."

**Bold Statements Calling for Change**

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¶4. (C) The Najib administration has identified several areas of the economy needing reform and has announced its intentions to carry out reforms through the NEM. In a December 1 speech to the Malaysian Institute of Economic Research, Finance Minister II Husni said Malaysia's economy was "stagnating" and highlighted Malaysia's most pressing economic issues needing to be addressed by the NEM as education, corruption, GOM economic over-management, weak public institutions, emigration, and low domestic investment rates.

**Education:** Husni said, "Our universities are a disappointment." He cited Malaysia as having its highest unemployment rate for recent college graduates while adding that there is a severe shortage of skilled workers, implying that large numbers of Malaysian recent college graduates are unskilled. Malaysian sovereign wealth fund Khazanah reported that skilled labor shortages and the poor quality of Malaysian graduates costs Malaysian competitiveness 15% of GDP annually.

**Corruption and Cronyism:** He cited the recently released Transparency International 2009 Corruption Perception Index, in which Malaysia fell to number 56 of 180 countries, its lowest rating in over 20 years, and continuing a fall from number 26 in 2004. Husni promised wholesale reform in government procurement practices, controlled by the Ministry of Finance, and an end to sole source contracts, except for the military.

**GOM Over-involvement in the Economy:** Husni called for the transparent divestiture of GOM interests in government-linked corporations (GLCs) and the restoration of the private sector's role as the primary engine for growth. He also cited that the GOM needs to discontinue open-ended protection of domestic industries, allow market driven resource allocation including greater precision in subsidy allocation, and foster better competition policies to spur innovation.

**Weak Public Institutions:** Husni criticized the lack of diversity in the civil service and proposed strengthening public institutions through greater ethnic participation.

**Brain Drain:** He noted barriers to non-bumiputras in the job market, starting and growing businesses, purchasing housing, and educational opportunities began a move of many well educated non-bumiputra Malaysians to emigrate. The fact that 800,000 young Malaysians are now working abroad, 300,000 having emigrated in the past 18 months, including increasing

numbers of ethnic Malays was recently noted in Parliament. Malaysia's "brain drain" has begun to get the attention of policy makers, according to Husni.

**Low Domestic Investment:** Since 1997, domestic investment rates halved from 20-25% of GDP annually to roughly 10% and have remained at reduced levels for the past decade. Husni said that the 1Malaysia concept is intended to introduce competition and move Malaysia to a more performance-based culture like Japan, Korean, and Singapore, promoting an attractive investment and working environment for all Malaysians.

#### NEM to be Broad and Wide-Ranging

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**¶5.** (C) The government and our contacts have released few details of the upcoming NEM. However, PM Najib announced December 22 at the Finance Ministry's "Media Night" that he had approved the NEM direction, and that the final model will be presented to the Cabinet and made public by the end of February 2010. The NEM will "set the direction of the economy and make the economy more resilient", according to Najib. NEAC Acting Director of Research Tong Yee Siong, said the NEAC met the week of February 1-5 to finalize its recommendations to the Cabinet for approval and public release by the end of February. Tong told Econoffs that the NEAC will produce goal papers and an economic model framework. Tong expected the recommendations to be very broad, and would propose a policy framework to address the most significant economic issues facing Malaysia and improve its economic competitiveness. Nicholas Zefferies, the president of AmCham, and the only "foreign" member of the NEAC, told Econ Counselor January 13 that NEAC reform recommendations to PM Najib would be wide-ranging. Zefferies said that Najib was planning to give NEAC powers similar to the Prime Minister's Special Task Force to Facilitate Business (Pemudah), to enforce the planned economic reform program on government Ministries.

#### Economic Reform Versus Ethnic Preferences

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**¶6.** (C) Tong told us that the NEAC is focused on removing disincentives to domestic investment established in the New Economic Policy (NEP) as a key to reinvigorating domestic and foreign investment. He added that any basis for serious economic and investment reform efforts in Malaysia involves dismantling old entrenched Bumiputra ethnic preferences established since the Mahathir regime in the NEP. Finance Minister II Husni's speech was important for connecting Najib's 1Malaysia slogan to real economic reform, according to Malaysian Institute for Economic Research Managing Director and long-time UMNO economic advisor Mohamed Ariff. However, as Husni criticized Malaysia's longstanding ethnic preference policies, he qualified his statements by asserting that "the government is not abandoning bumiputras" and that the government will pursue reform in "a prudent and cautious method" in an effort to allay bumiputra fears of economic displacement. Ariff told us that the Husni speech angered some senior UMNO members who complained that Najib was opening the economy too much and moving too fast toward reform. Opposition parliament members praised the speech, according to Ariff.

#### PM Najib Seeks Incremental Reform

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**¶7.** (C) Our economic contacts close to PM Najib said they were convinced he is sincere about wanting economic reform. Economic Planning Unit Deputy Director General K. Govindan, who briefs PM Najib and the cabinet weekly on Malaysian economic performance and economic policy, told us he believes PM Najib understands in general terms the reforms needed to improve human capital and productivity, increase trade and investment, and reduce corruption. Nevertheless, Govindan said he does not make specific economic policy recommendations at those meetings for fear of offending other

Ministers in the meeting who oppose the reform agenda. Ariff also believes PM Najib legitimately seeks economic reform. Ariff told us PM Najib's words to him were "change or be changed" when referring to economic reform. But Ariff also said he expected PM Najib to slowly pick away at the NEP without causing too much economic and political disruption. This will require regularly announcing small reforms rather than the sweeping reforms required to transform the economy. Ariff offered the February NEM release and the June 2010 release of the 10th 5-year Malaysia Plan as two upcoming opportunities for Najib to roll out more economic reforms.

#### Safe Won't Work

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¶8. (C) In the view of our economist contacts, PM Najib's "politically friendly" incremental strategy to economic reform may end up being too little too late. Tong projected that for reform to work, the PM will need to make a bold announcement on major reforms and then rally public support for change. Tong said that NEAC members are advocating that PM Najib announce significant structural changes to Malaysia's economy as a part of the NEM. Govindan agreed that major structural changes are needed for sustained economic growth. He added that a series of small reform programs will eventually limit Malaysia to an unacceptably low 3-4% annual growth rate that will keep the country trapped in middle income status until "politics are removed from education and the economy." The critical point, Ariff said, was that while Malaysia continued taking baby steps on economic reform, its competitors for investment such as Indonesia, Thailand, and Vietnam would be overtaking Malaysia as the first choice for foreign direct investment.

#### Ruling Party May Block Aggressive Reform

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¶9. (C) Each of our contacts agreed that political will is the key to reform, but none are convinced all of the coming announcements of plans to reform Malaysia's economy will be backed by substantially broad concrete measures. Ariff told us that after early enthusiasm for economic reform, some UMNO insiders do not want reform that would take away the economic rents and patronage system they have relied on to maintain the party's power base for over a generation. Ariff predicted that UMNO would not survive in power by moving to an open and transparent system and that UMNO insiders would challenge Najib if he moved too strongly on government reform. Govindan sees Malaysia's huge and largely ethnic Malay civil service, completely loyal to UMNO, but increasingly incompetent, as PM Najib's largest obstacle. He commented that the civil service has a very narrow world view and will oppose, even refuse to implement, reforms perceived as damaging ethnic Malay interests, even if convinced of the long-run gains for Malaysia. Tong told us that achieving any of the goals developed by the NEAC will require significant political buy-in to operationalize the policy changes necessary to reinvigorate investment and spur additional growth. However, Tong commented that NEAC members are frustrated with a lack of high-level political commitment outside of PM Najib as well as the slow responses from Ministries which impeded progress on the NEM. He added that some NEAC members are concerned that the NEM maybe merely a public relations exercise that will have no real long-term policy impact. Zeffries told us that he was not confident that PM Najib has a sufficiently strong political position to pursue the NEAC's upcoming proposals. Liew described the opposition closely watching economic reform, offering that an inability of the ruling coalition to implement promised economic reforms will provide powerful political ammunition for use in upcoming federal elections in 2012.

#### Ethnic Minorities Support Reform

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¶10. (C) Cheong sees her Malaysian private sector business clients as highly supportive of the type of economic opening she believes PM Najib will announce in the NEM and commented

that ethnic Chinese, Indian, and urban Malays not directly benefitting from UMNO patronage will strongly support economic reform efforts, but that rural Malays, a strong UMNO constituent base, will fear changes labeled as detrimental to Bumiputra interests. However, Cheong observed that Non-Bumiputras have successfully competed in the open economy at a disadvantage to Bumiputra and government linked businesses for over 30 years and that Malaysians would patiently wait for change. She added that the lack of investment is so obvious that the government is practically being forced to take action.

KEITH